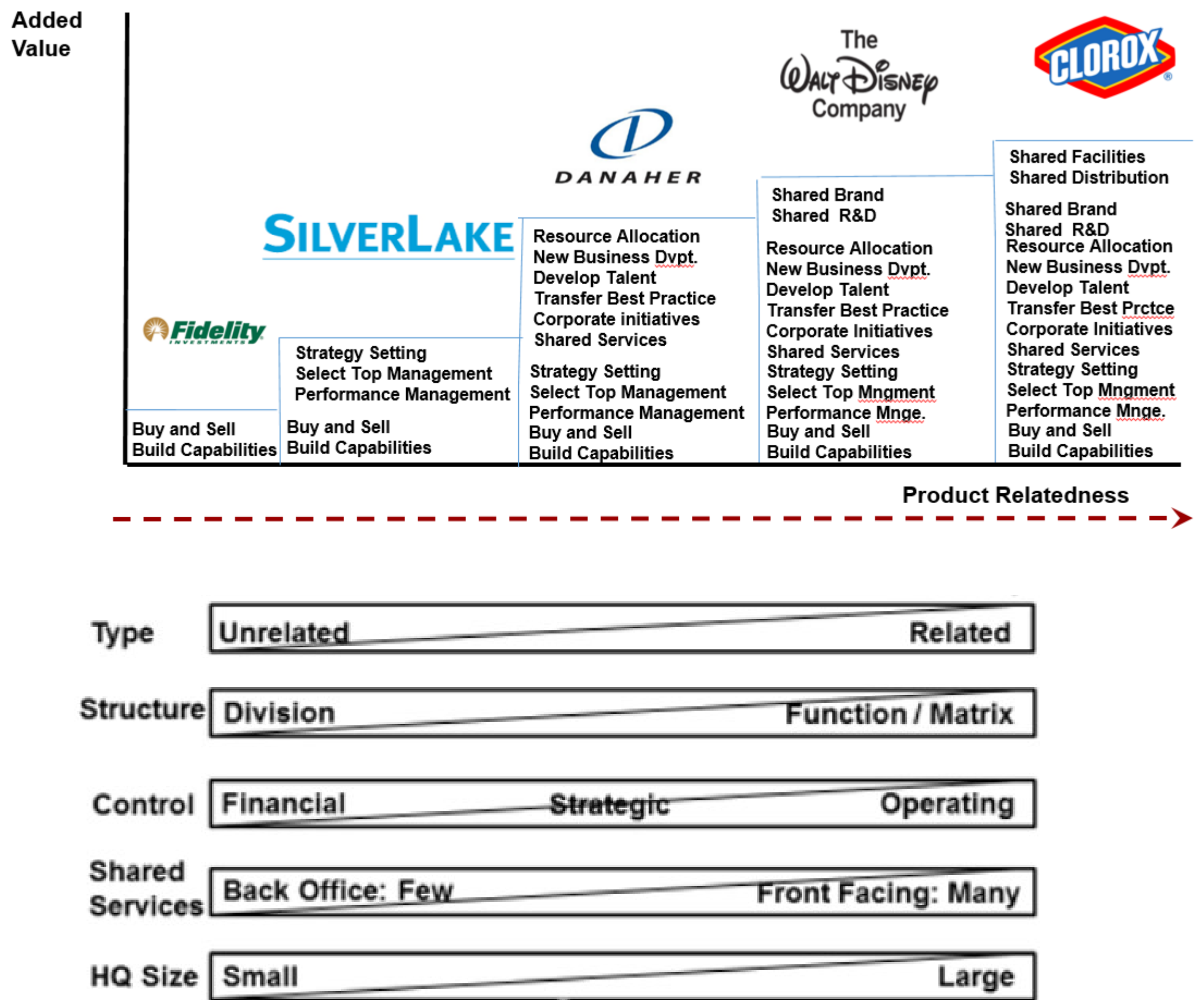
# ORGANIZATION: MANAGING THE CORPORATION

Ongoing management of the corporate portfolio is critical to realizing value in diversified companies. This requires designing and administering structures, systems and processes appropriate for the set of businesses and the resources that underpin value creation across the portfolio. It concerns the governance of the entity by corporate executives – what are the appropriate size, roles, responsibilities and authority of the corporate parent? How are business units controlled and coordinated to realise value across the portfolio?

## PRINCIPLES

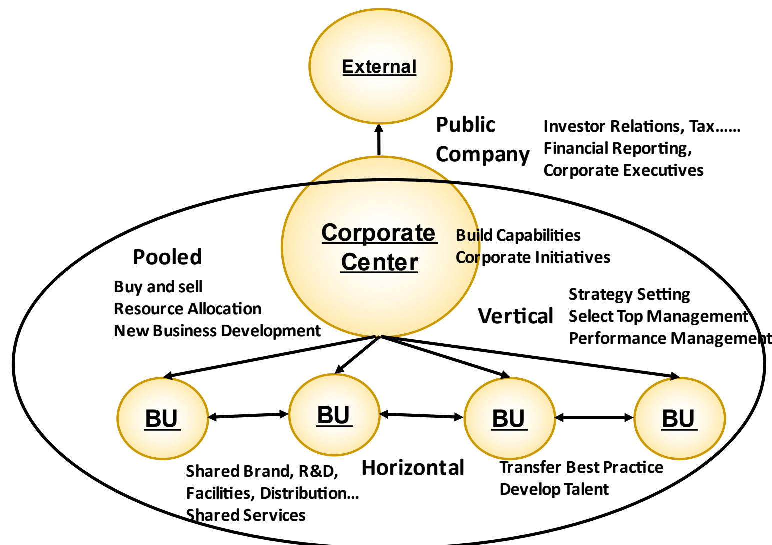
Two frameworks are helpful. The first is the corporate strategy continuum (Exhibit 1). Strategy is about consistency and alignment and, while not definitive, the continuum - arrayed along a dimension that summarises the degree of product relatedness in the portfolio – captures how activities performed by the corporate executives should vary, and how related elements of organization design, such as corporate headquarters size, will also vary.

Exhibit 1



The second relevant framework classifies the levers a CEO has available to manage the corporation (Exhibit 2).

Exhibit 2




Every company has to perform certain minimal functions as a corporate entity - filing tax returns, financial statements, communicating with investors…etc. These should and can be done at minimal expense, perhaps twenty people in a 20,000 FTE firm.

Every strategy has to be based on a unique set of capabilities that provide the underlying corporate advantage – a mutual fund needs a distinctive approach to stockpicking; a conglomerate needs a unique operating system, like DBS at Danaher. Every corporation must therefore invest in the resources and capabilities required for long term value creation – the Mickey Mouse that adds value to every business in the portfolio. Silver Lake, for example, has to develop initiatives for growing talent with pattern recognition skills and insights into the technology space.

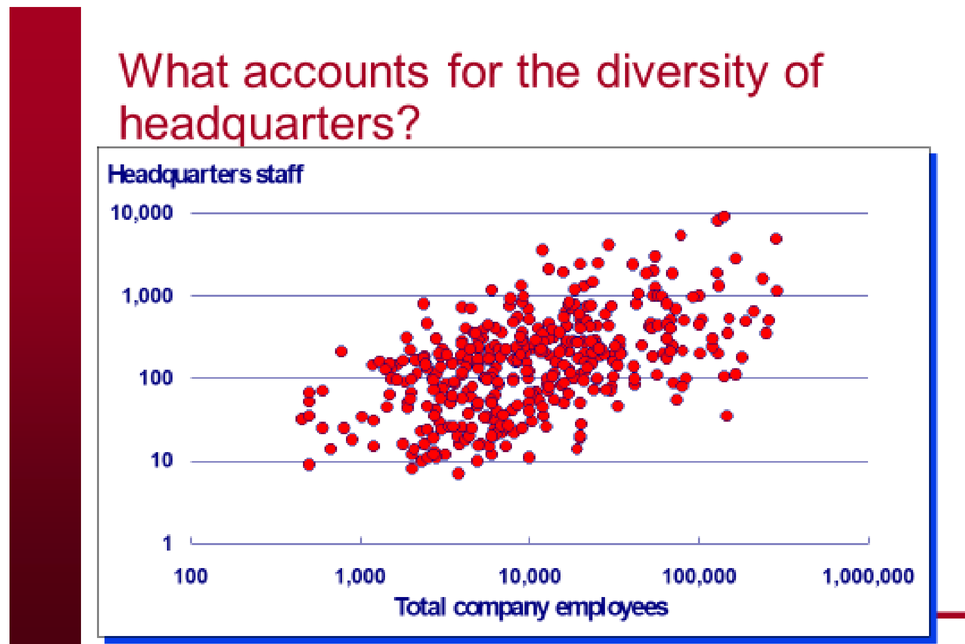
Ways to exploit those capabilities start with the decision about which businesses should be in the portfolio (buying and selling is the only decision that is made by a mutual fund); extends to ongoing resource allocation among independent businesses in the portfolio and supporting the development of new business models (pooled); adds processes to drive the performance of each discrete business by choosing executives, agreeing strategy and monitoring and incentivizing their operating and financial results (which requires a vertical relationship between headquarters and businesses); can include the

transferring of skills, like talent and best practices, across businesses; before culminating in sharing activities that directly exploit synergies among the business units (which requires horizontal coordination across businesses) and where major differences between companies typically arise.

As this framing makes clear how the managerial task becomes more intense as the corporate strategy moves from left to right, all these design choices will still be made with an eye to minimizing the cost of the corporate center – both the direct expense of the headquarters and the indirect bureaucratic cost imposed on businesses.

As the extent of management tasks increase along the continuum, so other elements of organization design have to align. For example, the structure of the entity will vary from discrete and self-contained operating units through to a functional organization or even perhaps a matrix structure. If there is very little that is shared between the product divisions, there need not be any organizational overlap. In contrast, when there are many activities in common, the need to integrate shared functions requires extensive coordinative activities. This explains why there is such a range in the size of corporate headquarters. There is not one right size of headquarters since it depends on what purposes the headquarters have to fulfill (Exhibit 3). At 10,000 employees, a successful financial services company with a large IT function might employ 1,000 people at headquarters (it is located at the right end of the continuum), whereas a successful private equity firm might employ 10 professionals (located at the left hand end of the continuum).

Exhibit 3



## ***PRACTICE***

*STRUCTURE*: Organisation design for the diversified corporation balances business unit autonomy with the need for coordination across the enterprise to realise synergy (the balance of differentiation and integration identified by Lawrence and Lorsch (1967)). Independent and self-contained business units run by entrepreneurial managers with the minimum of bureaucratic intervention allows a focus and specialization on that business. By matching authority with responsibility managers can be incentivized and clearly held accountable for their performance. Such a structure optimizes the stand-alone performance of the individual businesses and is why firms at the left end of the continuum typically adopt the divisional form (or are legally obliged to maintain discrete portfolio companies). When sharing activities, such as Clorox's single supply chain, becomes an important source of value creation, the structure has to be functional or a matrix of function and operating units, such as in P&G's O2005, in order to effectively coordinate across businesses (Galbraith 2008).

However, the "Principle of Organizational Suboptimality" suggests that no structure is ever capable of achieving the ideal balance of independence and cooperation. This suggests that a firm should put in place the structure that addresses the most salient current needs. Management tells employees this is not a panacea; there will always be reasons to find fault, so stick with it for – at least seven years – before changing it when the organization has learned to exploit weaknesses in the structure. To offset those weakness, executives introduce processes that support the under-represented dimension, whether vertical or horizontal, in the current organization design.

PROCESSES

*Corporate Functions:* It is helpful to separate three broad types of role that, even a single function, such as financial accounting and reporting, can play (Exhibit 4). The first are the Core/Obligatory functions required of a legal entity, such as taxation, accounting, investor relations, or those that are critical to the integrity of the corporation like cash management or SHE in pharma companies. For these, the corporate center has to act as a **policeman or guardian** with full rights to intervene and impose requirements that business units act a certain way and follow certain rules. The second are shared services, such as the central provision of purchasing or payroll processing. In this role the corporate unit treats the businesses as their **customer**, often going so far as to establish a service level agreement (SLA) with each unit. The third type of roles are Value Adding which are best conceived of as Centers of Excellence that coach or **consult** to the BUs and which are accepted and utilized because the functions are recognized as experts in their field and **partner** with the operating units eg the Marketing group at Clorox.

Exhibit 4

**ROLES OF THE CENTER**

| Corporate Functions | Number of FTE's | Role | Typical Activity | Assessment Methodology |
|---|---|---|---|---|
| OBLIGATORY/ CONTROL | # # # | Guardian: Compliance and Authority | Examples: • Corporate executives • Financial reporting • Mgmt Reporting | • Measure against external benchmarks and statistics |
| VALUE ADDED | # # # | Advisor: Education of Client | Examples: • Talent Development • Business Development • Globalization • Purchasing Function • Manufacturing Function | • Develop a strategy statement for each function • Measure performance against the deliverable |
| SHARED SERVICES | # # # | Implementer: Order Taker Service to the Business | Examples: • IT • Pension Administration | • Develop a service-level agreement • Use a "market test" (likelihood of being outsourced) |

*Core Functions*: Applying this framing, let's start from the activities that all public corporations have to perform which can only be undertaken by corporate executives and for which all seek to minimize the cost. These are the **minimal corporate headquarters functions** including financial reporting, external relations, capital raising and allocation, and responsibility for oversight of the individual businesses by corporate executives. Perhaps surprisingly, this can be done with a very small office – thirty people for even a 20,000 person company. Just look at private equity firms that control entities employing hundreds of thousands with a tiny staff. Silver Lake, for example employs 400,000 in their portfolio companies, but only 150 professionals itself. Benchmarking this role is possible with the intent to build a lean headquarters that has minimal interference in the operation of the businesses (Young et al 2000).

Initiatives to Build Corporate Capabilities: Every company must make adequate investment in the resources and capabilities that drive value creation – the Mickey Mouse. Whether it is a private equity firm building a unique culture and winning the talent battle, Disney acquiring high quality franchised content, or Edward Jones ensuring that FA's diversity matches the distribution of wealth across the population, every firm faces "must-win battles" that determine their long run success. It is only the CEO who can oversee investment and monitor progress towards winning those battles by making them **corporate initiatives** as we see with Joe Kaeser's digitalization initiative at Siemens; Bob Iger's content, technology and globalization initiatives, or Kasper Rorsted's continued pursuit of speed, open innovation and cities (a focus on trends in a limited number of locations) at Adidas.

To be effective corporate initiatives must be limited in number (less than seven); adhered to for the long term (so they do not become the "flavour of the month" that can be politely avoided); and provided adequate investment and oversight from the CEO. Supported by metrics and accountability they need to be embedded in other processes, like strategic planning. To gain traction, it helps to start by picking the low hanging fruit with projects that quickly demonstrate viability in order to build support with all business units by pointing to symbolic victories.

While often referred to incorrectly as "Corporate Strategies", initiatives shape selection of the many individual projects and experiments that every firm pursues as it adapts to an ever-changing external opportunity set.

*Pooled Functions:* Resource Allocation: Although the resource allocation lever can be overused, portfolio management is one of the more powerful tools available to the CEO. McKinsey demonstrates that more intensively rearranging resources across businesses increases performance. Arithmetically, if the corporation is able to move capital from lower to higher profit businesses, the overall return will increase. As we will see in the Shell discussion, contemporary **portfolio management** concerns more than just capital allocation. A sophisticated approach, pursued by the majority of large companies today, also uses it to allocate people, set targets, and ensure a balance of growth and profitability in the corporation.

Shared Services*:* Shared services range from activities that might benefit from scale economies (and might even be outsourced to third parties), such as payroll processing, to a common supply chain organization that supports the full set of product divisions, such as at Clorox, or shared purchasing at Maersk. As the strategy becomes more related, the value of sharing activities increases and so does the type and size of this function at headquarters.

Shared services can be of substantial size, particularly if they are core to the operations of the entire corporation. In a bank, for example, the IT function has to run all the programs to maintain operations of every business line. As a result they can employ thousands and reach 10% of total employment as they support and develop applications for every business unit.

The argument for having a shared service is that it can provide the service at lower cost (and higher quality) by exploiting scale economies. There is typically a market alternative – either the business performs the activity itself (DIY) or a third party vendor (such as ADP for payroll processing) – and if the corporate shared service function cannot beat that alternative, it does not deserve to exist. As a result the relationship is best conceived of as a **service level agreement** (SLA) even if it is not formally accounted for in that fashion.

*Vertical Relations:* Performance Management or Control: There are basically two ways in which corporate management can monitor and drive performance of individual business units (Eisenhardt 1985)[1]. The first is **operating** control, in which executives oversee the actual behavior of divisional management. This is what we saw when corporate executives observe daily supermarket sales report (Clorox), or conduct monthly "brackets" meeting to get into the detail of 30 P&L line items (Newell). While not making decisions themselves, corporate management can evaluate the behavior of divisional executives and reward them on that basis – even if budgets were missed because of covid-19, the actions of divisional executives in response to the pandemic can be assessed. Corporate management can also provide guidance and advice to divisional management because they have experienced similar situations many times before in similar businesses. This control mechanism requires executives who have a familiarity with those businesses – usually from having previously operated them – and that all businesses are subject to "similar" drivers of success. This is usually applicable at the related end of the continuum.

[1] Clan control is a third mechanism.

In contrast is **outcome** control. This is appropriate when the portfolio is much less related and corporate executives do not have experience in the businesses. In this approach, business unit heads are held accountable for their financial and strategic performance. At Maersk, divisions commit to deliver against certain targets, and at the end of the year are rewarded on that basis. Since corporate management knows less about the details of the business, exogeneous events, like the pandemic, cannot be accounted for and divisional managers have to bear that risk. The carrot offered divisional executives is a rich incentive scheme for hitting targets (in private equity typically an equity stake). The stick is ultimately the threat of being replaced.

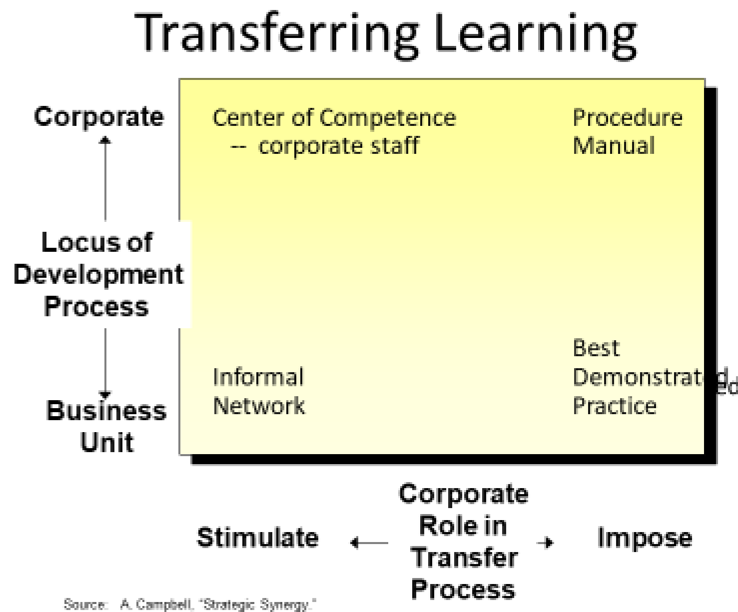
The dichotomy between control systems is perhaps overstated since there are elements of both control mechanisms in any performance management system and the use of strategic targets is often seen as an intermediate mechanism (Goold and Campbell 1987). However, it is important to recognize that the extent to which it is useful for corporate management to get into the weeds of a business – asking, for example, when sales in China were below budget whether the unit had hired the six additional sales reps approved in the budget – will fundamentally differ between the two.

*Horizontal Coordination:* Finally are the value-adding functions, such as managing the brand franchises at Disney, developing core technologies at Samsung, or continually driving operational efficiencies in the supply chain at Clorox or with DBS at Danaher. The extent and size of such functions will vary along the corporate strategy continuum to ensure they deploy the resources that drive value creation across the businesses.

Transfer Skills and Learning: One of the more effective ways to add value to businesses is by **transferring skills,** and the people in whom those skills vest, across units. Danaher's DBS is an example of a corporate process applied within every business. The advantage of this approach is that units can operate separately while benefitting from the capability so there is no conflict between exploiting synergies (value adding) and autonomy.

Two dimensions, capturing who develops and who has the authority to deploy such skills demonstrate how to organize this process (Exhibit 5), and illustrates how the roles of corporate staff have evolved over the years. Business units are always striving to improve their performance by experimenting with new processes and learning new skills. Alternatively, corporate staff can be responsible for advancing the latest ideas to improve the practice of their function. When a best practice has been identified in either of these ways, its adoption can be mandated by corporate headquarters or left to the preference of individual units.

Exhibit 5




In the resulting matrix, the top right was the location of corporate headquarters staff in the bad old days of big bureaucracies. Staff would mandate a way of doing things, perhaps captured in a manual that specified detailed procedures to follow, whose observance in every business was then closely monitored. In contrast, the lower left quadrant relies on informal corporate networks to both develop and drive adoption of new practices. Moving to the right, the corporate centre can stimulate adoption of new ideas by highlighting effective processes in newsletters or at corporate meetings, like Jack Welch's annual sessions in Florida for the top 300 GE executives. At the bottom right, corporate then demands that every business unit adopt the practice, just as Jack Welch did with, for example, his six sigma initiative.

At the top left is perhaps the most common contemporary role for a corporate function as a centre of competence. Indeed, the corporate HR function typically plays a critical role in transferring skills through a formal management development program that moves personnel across businesses. Indeed, in many corporations it is the CEO who takes responsibility for the appointment of the top cadre of managers since talent is the most important legacy in an organization. Managing the careers of, typically, the top 5% of executives and moving them regularly across businesses, functions and geographies ensures that the accumulated knowhow in the organization is deployed most effectively.

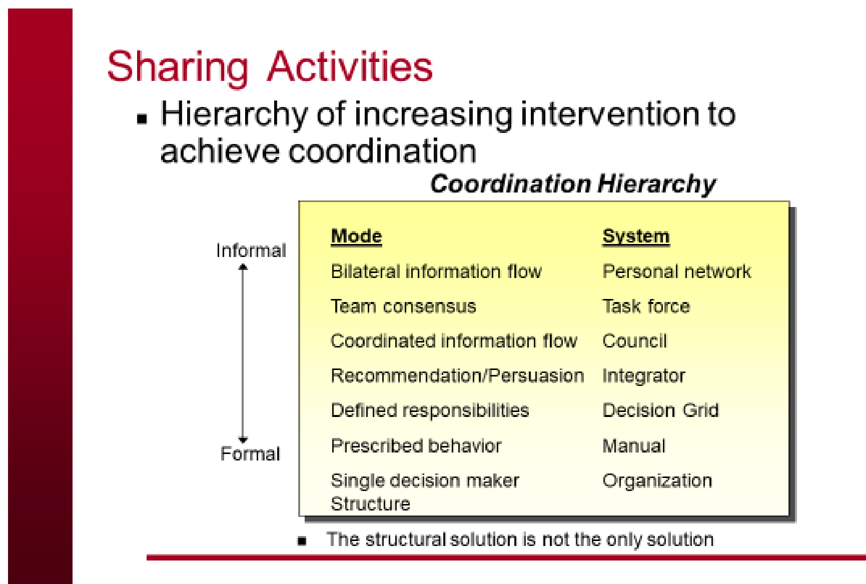
Share activities: Sharing activities – whether a supply chain (Clorox), an Imagineering department (Disney), distribution through the "hot zone' (Cadbury) or the IT function managing EDI links with customers (Newell) – is the most obvious way to generate synergy by exploiting economies of scale. Yet sharing inevitably involves compromise. Pepsico took 18 months to get agreement amongst its three restaurant chains (later spun-off as Yum Brands) to share the purchasing of toilet paper. One wanted cheap one-ply, another softer three ply and so on. After agreeing they collectively saved $1.5

million per annum, but the loss of independence shows why this sort of coordination is the most difficult to achieve and should only be employed when truly valuable (likely at the right end of the continuum).

As a consequence, only what truly benefits from being shared, should be shared. The **"Principle of Selective Coordination"** led Maersk to move 80% of purchases under the group function, but delayed incorporating the most important items to each unit, such as the container ships, until later. Similarly, Pepsi restaurants allowed Kentucky Fried Chicken to source its own chicken since that was central to its value proposition.

Nor is a structural solution the only way to coordinate activities across business units (Exhibit 6). Companies can work their way up a hierarchy towards more formal methods of coordination starting by supporting a network of relevant personnel from different business units, moving to ad hoc project teams that resolve a contentious issue – perhaps the location of a shared manufacturing facility – before establishing a council as a permanent forum for ongoing conversations on topics of interest; and ending with the appointment of an individual who has responsibility but not authority for coordinating activities across businesses.

Exhibit 6




## CONCLUSION

The complete and complex design of a corporation's administrative system has to start from knowing what is the corporate strategy. Clarity around where along the corporate strategy continuum the firm is located can provide guidance as to the alignment of all the management processes employed to create value. When that location alters, as we saw with Maersk which has gone from an agglomerated mess of businesses, through a "premium conglomerate' with a smaller corporate staff, to an integrated logistics company after divestment of non-shipping businesses with headquarters for the integrated entity, so too must the organization design.

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